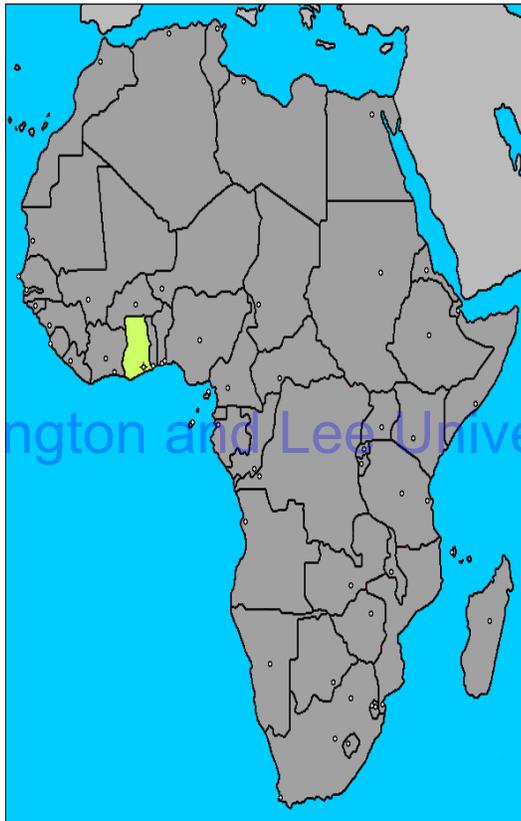


Poverty Capstone: Microfinance in Rural Ghana



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I. Introduction

“I, Apasare from Walewale have lived my adult life as a cotton farmer and produce just a little of maize and millet for home consumption. I have a family of nine and I managed to sponsor four of my children through school. The cotton production was good and the price offered was also good and the Board (Cotton Development Board) readily pays. They also provided the required extension service, inputs such as seeds, fertilizer, chemicals and could even support in obtaining credit. Since nearly eight years ago, the situation changed. Seeds for sowing are even difficult to obtain, we were left on our own to search for inputs. Obtaining extension support became an expensive favour while accessing credit was out of the question. I realized I was becoming poorer every year as I owed moneylenders more than what I realized from cotton sales. My food barn also reduced drastically so I stopped producing cotton but the only alternative was to produce watermelon, which also has its own pricing problems. In a matter of four years I have become a poor man and when my child qualified for secondary school, I could not sponsor him. My situation represents the case of many families here.”ⁱ

Apasare’s story of an inability to access credit and financial services attests to a key barrier faced by people throughout Ghana. This barrier contributes to the persistence of poverty and requires innovative solutions. The extension of small loans or microloans to poor persons, such as Apasare, who do not have access to traditional financial services, due to lack of credit, collateral, money to start a savings account, and resources is known as microlending.ⁱⁱ Microlending is a thriving market with great potential to transform the lives of developing-world entrepreneurs and alleviate poverty across the globe.

For the past three decades, microlending has been seen as a tool for nonprofit economic development. This phenomenon began with Muhammed Yunus, a Bangladeshi economist and economics professor, when he began supplying \$27 loans to women in Chittagong, Bangladesh.ⁱⁱⁱ Eventually, Muhammed Yunus established the Grameen Bank and won the 2006 Nobel Peace Prize.^{iv} This industry, fathered by Yunus, has drastically changed over the past 30 years from what began as a collection of individual non-governmental organizations funded by donors to become a professional business offering much more than credit to the poor, but also a full range of business services.

While microfinance is not a panacea for poverty, when properly channeled, it can impart sustainable positive impacts as financial investment can lead to the empowerment of people, which in turn may promote confidence, self-esteem, production, and ultimately less poverty.^v

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The role of microfinance has evolved out of 5 key factors:

1. The fact that the poor need access to productive resources, particularly financial services, to be able to improve the conditions of their lives;
2. The realization that the poor have the capacity to use loans effectively for income-generation, to save and re-pay loans;
3. The observation that the formal financial sector has provided very little or no services to low-income people, creating a high demand for credit and savings services amongst the poor;
4. The view that microfinance is viable, sustainable, and could achieve full cost recovery;
5. The recognition that microfinance could significantly impact cross cutting issues such as women's empowerment, reducing the spread of HIV/AIDS and environmental

degradation as well as improving social indicators such as education, housing and health.^{vi}

This paper will explore microfinance in rural Ghana. First, it will begin with an overview of Ghana's overall approach to poverty reduction followed by an overview of the current poverty situation in Ghana. The next section will describe the promise for microfinance, including what the loans are used for and what benefits and outcomes microfinance produces. The fifth section will describe why credit is especially needed in the agricultural sector of the rural economy. The sixth and seventh sections will explain the current services available in rural Ghana and the inadequacy of the current services. The eighth section describes obstacles to providing microfinance in rural areas as opposed to urban areas. The ninth section outlines the proposed reforms needed in Ghana to achieve the potential benefits of microfinancing. The tenth section describes the limitations of microfinancing and is followed by the conclusion. Ultimately, I will argue that access to credit is vital for the rural poor in Ghana and to reduce poverty in such areas. I will further argue that the current services are inadequate and that a combination top-down and bottom-up approach, involving the financial institutions and grassroots efforts respectively, is warranted to provide these services to the Ghanaian rural poor.

II. Ghana's Policy Framework for Microfinance as a means of Poverty Reduction

In September, 2005 policy leaders gathered to establish the framework and objectives for poverty reduction for the years 2006-2009. These policies are entitled Ghana's Growth and Poverty Reduction Strategy (GPRS II). The central goal of the new policy was to accelerate growth of the economy such that Ghana could achieve middle-income status by 2015 in alignment with the Millennium Development Goals of halving world poverty.^{vii} The main objective of GPRS II is to ensure "sustainable equitable growth, accelerated poverty reduction

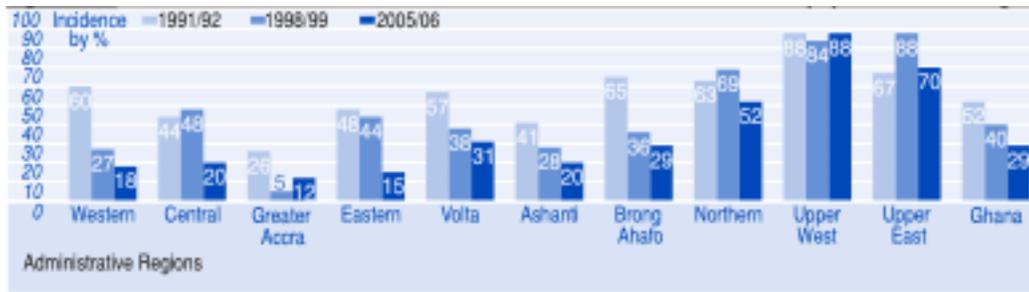
and the protection of the vulnerable and excluded within a decentralized, democratic environment.^{viii} It seeks to balance growth and macroeconomic stability with human development and empowerment with the goal of reducing poverty levels in the medium term.^{ix} The importance of this goal is highlighted by the fact that the poor constitute the majority of the working population.^x

GPRS II's overall strategy emphasizes reduction of inflation and the fiscal deficit as key steps to lower interest rates and prevent the public sector from crowding out the private sector in the financial markets.^{xi} Because Ghana has a fiscal deficit, it turned to financial markets to obtain money, generating demand beyond the baseline demand from private industries, thus increasing interest rates. GPRS II identified microfinance as a primary tool to combat this specific problem in Ghana because increasing and diversifying credit supply through microfinance institutions should lower interest rates per standard economic principles.

III. Ghanian Poverty Overview

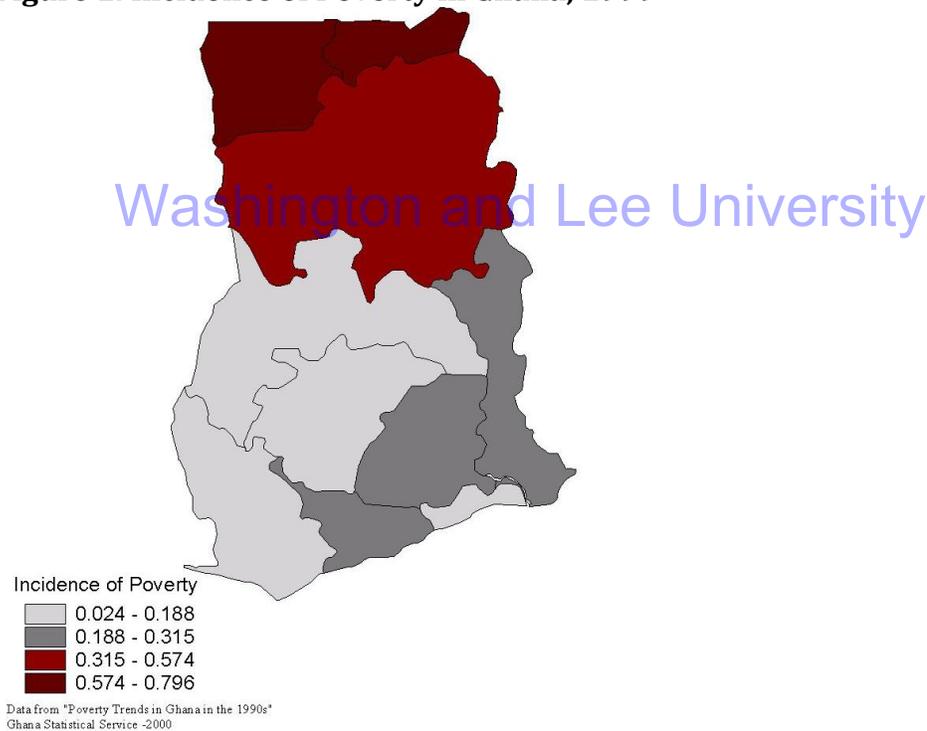
The Ghanaian economy has grown at an average annual rate of 4.5 percent over the past two decades.^{xii} This growth has contributed to a reduction in overall poverty. The most recent Ghana Living Standards Survey in 2006, which uses the World Bank standards for measuring poverty, reported a decline in the proportion of Ghanaians described as poor from 39.5 percent in 1998/99 to 28.5 percent in 2005/06.^{xiii} Those described as extremely poor declined from 26.8 percent to 18.2 in that same time period. The table below breaks down the poverty rate by administrative regions.

Table 1: Incidence of Poverty by Administrative Region^{xiv}



This table clearly shows that a majority of poverty in Ghana is concentrated in the upper regions of the country, which include the Northern Region, Upper West Region, and Upper East Region. Apasare is from Walewale, which is located in the Upper East region of Ghana. Figure 1 below is a map that illustrates the incidence of poverty throughout Ghana.

Figure 1: Incidence of Poverty in Ghana, 1999^{xv}

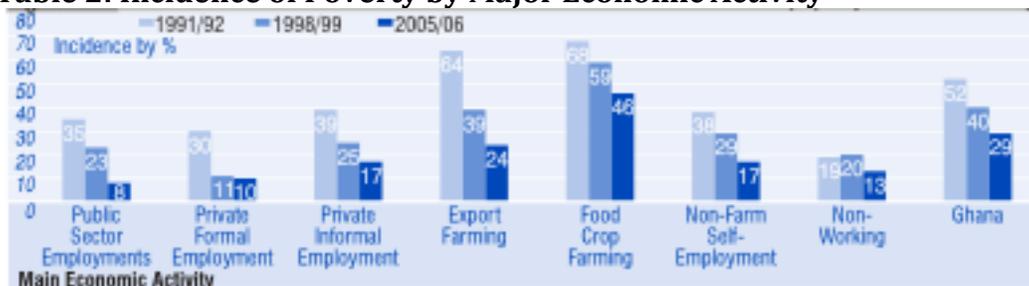


This map also highlights the great disparities that exist between the north and the south. Geographic factors can account for a great deal of the disparities that exist between the north and south. The Upper East and Upper West regions are covered by Sahel savannah in the north-east and grassland savannah in the north-west. There is one short rainy season,

followed by a long period of dry weather influenced by the dry harmattan wind from the Sahara Desert.^{xvi} The three northern regions are predominantly rural areas and lack basic social services, financial institutions, safe water, all-year roads, electricity, and telephone services.^{xvii} Seventy percent of the country's poor people live in rural areas of Ghana.^{xviii}

These geographic conditions also contribute the differing poverty trends among various economic sectors (Table 2).

Table 2: Incidence of Poverty by Major Economic Activity^{xix}



Poverty is particularly pervasive within two sectors of the Ghanaian economy: agriculture and the informal sector.^{xx} With 46 percent of food crop farmers characterized as poor in

2005/06, this group is the worst off. Farming is confined mainly to the short rainy season.

In the dry season farmers can cultivate land only under irrigation. Most farmers are idle during this period. The major factor that inhibits the three northern regions access to

credit is their reliance on a single food crop production season, which leads to low productivity. Additionally, the failure rate of loan applications contributes to the

problem.^{xxi} Insufficient income and difficulties raising the needed collateral are the leading

causes for rejecting loan applications. Among the different business sectors, agriculture suffers the greatest rate of loan application failures.^{xxii} This situation stems from the fact

that agriculture in Ghana, unlike industry and business, is highly dependent on natural climatic conditions over which there is little human control. Throughout Ghana, rural

people cope with poverty in various ways, finding individual solutions to the problem. Men take off-farm employment, women carry on small-scale trading, and families reduce cash spending, which may mean taking children out of school, which was the case for Apasare.

IV. Microfinancing: Uses and Outcomes

In alignment with the first key factor of microfinance, access to financial services is vital for the poor to improve the quality of their livelihoods. Credit and savings facilities can help poor rural households manage and augment their meager resources and acquire adequate food and basic necessities for their families. Financial services assist the poor in three areas: business opportunities, business asset procurement, and social responsibilities.^{xxiii} Microloans transfer capital to the poor, which gives them the opportunity to start a new business or enhance their existing one. In either case, the availability of necessary inputs is crucial to profitability. Crop inputs for farmers include seeds, fertilizers, and other agricultural tools. Loans may also support non-crop activities including dairy cow raising, cattle fattening, poultry farming, weaving, basket making, cloth trading, and pottery making.^{xxiv} Procurement of business assets is the second use of microloans. By providing the poor with funding to obtain assets or capital machinery (i.e. irrigation pumps, sewing machines, corn mill, tractors), it allows their business to operate more efficiently and at a higher capacity, thus increasing profitability. The third use of microloans is for social responsibilities. The poor use the loan to finance health problems that may occur, to fund education, or to fund household emergencies that occur.

The outcomes and results of microfinancing are highlighted in three main areas: employment generation, increased person network, and empowerment.^{xxv} When the poor are given the financing to expand their business, jobs are created. These new employment opportunities strengthen the local economy. Microloans also increase the poor's personal net

worth, which includes their personal savings, income investments in household assets, improved nutrition and health, and education. An increase in net worth helps very poor households to meet basic needs and protects against vulnerability and risks. This outcome provides evidence for the fifth key factor for successful microfinancing because it has cross-cutting effects on significant issues such as improved education and health. The third effect of microfinancing is empowerment, which is also part of the fifth key factor. When the poor are able to successfully repay loans, it leads to a higher self-confidence and feeling of empowerment. This also leads to the poor participating more actively in the economy and society.

V. Credit need for agricultural section

In Ghana, access to credit by the poor is constrained by their inability to provide the required collateral and their being perceived as a credit risk. According to Zeller, rural areas are characterized by higher transaction costs, higher systemic risks, lower risk-bearing ability and higher vulnerability with respect to financial and occupational concerns.^{xxvi}

In alignment with the disparities discussed above between the north and south, there are regional variations in access to credit. The Ghana Living Standards Survey in 1998/1999 found that the proportions of households obtaining credit twelve months before the Survey are the Northern Region (3.5%), Upper East Region (1.3%) and Upper West Region (0.9%) whereas Ashanti and Western Regions have rates of 22.3% and 15.5% respectively.^{xxvii} Additionally, seven of the 18 districts in the north have no banks, and the ratio of clients to banks is 100,000 to 1 (as opposed to 16,000 to 1 in the country as a whole).^{xxviii} This observation represents the third key factor that drives the evolution of microfinance because it demonstrates how the formal financial sector has provided little or no service to low-income households. Where people lack access to viable financial services in their communities they tend to be deprived of the

opportunities of raising capital to initiate and expand their businesses, thus hindering their ability to improve life conditions, in alignment with the first and second key factors for successful microfinancing. A Citizens Assessment Report indicates that 78% of all rural households, and 87% of Northern region households, have no accounts or any form of useful relationship with any potentially useful financial institutions.^{xxix} This clearly shows that the majority of the poor, mostly food crop farmers and artisans of the informal sector, are excluded from formal or institutional credit or capital. It also implies that all poverty reduction responses and social funding activities that use the financial institutions as intermediaries, indeed, exclude these groups.

Due to agriculture being the core of the Ghanaian economy, it stands as a principal sector for development and growth of the economy. Yeboah explains that, “The importance of the rural sector to the economy and the extent of poverty in this sector make the application of microfinance interventions essential.”^{xxx} However the current supply of microfinance is inadequate. Studies by Parker and Aryeetey provide empirical evidence to show that between 24% and 52% of entrepreneurs in agricultural sector in Ghana mentioned credit as a major constraint to expanding their businesses.^{xxxi} Additionally, the commercial banking system, which is comprised of 23 major banks, reaches only about 5% of households and captures 40% of money supply.^{xxxii} Therefore, there is room to expand the microfinance sector in Ghana, especially in the agriculture section.

VI. Current Services

The term “rural and micro finance institutions” (RMFIs) refers collectively to the full range of financial institutions that serve rural clientele including farmers, rural households, the poor, and microenterprises.^{xxxiii} Over the years, Ghana’s approach to macroeconomic policy

surrounding RMFIs was to encourage entry and then make adjustments to regulate the institutions.^{xxxiv} This strategy has fostered a wide range of RMFIs that can be classified into three tiers: formal, semi-formal, and informal. The strength in Ghana’s approach is the diversity of institutions that exist. However, this approach also has its drawbacks. For instance, it fosters a large amount of weak institutions. Table 1 outlines these three categories with definitions, the types of institutions, and principal clients.^{xxxv}

Table 3: Segments of Financial Systems by Degree of Formality^{xxxvi}

| Tier | Definition | Institutions | Principal Clients |
|---|--|---|---|
| Formal banks | } Licensed by } central bank | Commercial & development banks | Large businesses Government |
| Specialized non-bank financial institutions (NBFIs) | | Rural banks Post Bank Savings & loan companies Deposit-taking microfinance banks | Large rural enterprises Salaried workers Small & medium enterprises |
| Semi-formal | Legally registered, but not licensed as financial institution by central bank | Credit unions Microfinance NGOs | Microenterprises Entrepreneurial poor |
| Informal | Not legally registered at national level (though may belong to a registered association) | Savings (susu) collectors Savings & credit associations, susu groups Moneylenders | Self-employed Poor |

The commercial banking system, which is dominated by a few major banks, reaches only about 5% of households.^{xxxvii} Most households are excluded by the commercial banking system because they cannot afford the high minimum deposits required.^{xxxviii} With 60% of the money supply outside the commercial banking system, the rural banks, savings and loans companies, and the semi-formal and informal financial systems play a particularly important role in Ghana’s private sector development and poverty reduction strategies.^{xxxix}

Formal Sector

The formal sector includes suppliers such as rural and community banks (RCBs), and development and commercial banks, and savings and loan companies. Rural Banks were first introduced to Ghana in 1976 in response to the growing concern about the inadequacy of the

financial services for the rural poor.^{x1} There was a need to expand savings mobilization and credit services in rural areas, which were not served by the commercial and development banks. Rural banks are meant to use microfinance methodologies to provide financial services to the rural communities.^{x1i} Members of the rural community purchase shares to become owners in rural banks.^{x1ii} Rural Banks are formally licensed by the government to provide services in rural areas.^{x1iii} Community members serve on the board of directors who have the responsibility of dictating the policies of the banks.^{x1iv} To date there are 123 rural banks in Ghana.

RCBs make standard commercial loans to individuals or groups, often related to agriculture. RCB loans are generally short term (4-6 months) with weekly repayment, averaging around \$50-75, with a compulsory up-front savings of 20% that is retained as security against the loan.^{x1v} RCBs use both individual and group savings and credit programs. Group lending uses peer pressure as a tool to ensure repayment. Individual members in a group feel an obligation not to let each other down and thus repayment rates are higher in group lending.

In order to accommodate the nature of agricultural businesses, in regards to the longer time period it takes from the time an investment is made until profits are realized, RCBs utilize term lending. This type of lending gives borrowers an extended time before payments are due; however, at the end of a loan, there is a balloon payment, which is a large one-time payment that makes up for the period in the beginning of the loan when the borrower did not have to make payments. Term lending tends to result in portfolio performance problems, as borrowers can have difficulty making balloon payments and RCBs have weak capacities to follow-up and enforce repayment.^{x1vi} Recently, more progressive RCBs have been relying more heavily on microfinance techniques to introduce new programs for savings and credit, often in a partnership with NGOs that provide auxiliary services. For example, Nsoatreman Rural Bank pays a 2%

commission to an NGO that helps identify, mobilize, and educate rural groups on accessing credit through an International Fund for Agricultural Development (IFAD) program, as well as to assist in loan monitoring and recovery.^{xlvii} This program has been extremely effective with a repayment rate of 98%.^{xlviii} Linkages between RCBs and NGOs lay a vital foundation to expand outreach to rural poor clients. RCBs provide the financial aspect, while grassroots efforts assist in reaching the rural poor by decreasing the transaction costs.

A few RCBs in Ghana have succeeded in expanding to more than 20,000 clients and reaching high levels of operational and financial sustainability.^{xlix} On average, Ghana's RCBs are small compared with other African MFIs, especially in terms of lending.¹ Despite their size, they have achieved higher profits relative to other African MFIs, mainly because of high interest rates on treasury bills (T-bills) and high reserve requirements.^{li} Over the years, RCBs have faced several struggles including rapid inflation, currency depreciation, economic decline, mismanagement of funds, and natural disasters, which led to only 23 out of the 123 RCBs in 1992 qualifying as "satisfactory."^{lii} In response to the poor performance of RCBs, the Ghanaian government decided to increase the reserve requirement that RCBs had to maintain.^{liii} An increase in the reserve requirement meant that banks had to keep larger amounts of money and liquid assets on hand in cash. This decreased the supply of money that banks had available to lend and therefore decreased the amounts of loans that were issued. This regulation came at a time when T-bills were earning high interest rates. High interest rates on T-bills, coupled with high reserve requirements, suppressed Ghanaian RCBs' incentives and ability to lend money. When interest rates on T-bills are high, banks invest their excess money in T-bills at a high interest rate because it is a profitable and low risk investment. Therefore, the consequence of increased reserve requirements and high interest rates on T-bills is a decrease in the amount of

loans available to the rural poor, and, therefore, RCBs are much more selective in choosing their borrowers. In summary, higher reserve requirements together with high interest rate on T-bills have been largely responsible for the improvement of RCBs' financial performance and profitability, but this process has the unfortunate side effect of decreasing availability of loans to the rural poor. Finding the right balance will be important for RCBs, which now constitute the backbone of rural financial services. Table 4 provides data on the outreach of each of the rural microfinance institutions in rural Ghana.

Table 4: Outreach of Rural and Micro Finance Institutions by Type^{liv}

| Institution | Depositors | | Borrowers | |
|----------------------------------|------------------|------------------|----------------|----------------|
| | 2003 | 2004 | 2003 | 2004 |
| Savings & Loans (10) | 194,904 | 243,888 | 19,454 | 44,651 (est) |
| Credit Unions (240) | 118,288 | 160,459 | 75,869 | 83,804 |
| Rural & Community Banks (115) | 1,202,416 | 1,509,413 | 183,368 | 221,818 |
| NGOs (29) | 36,729 | 87,423 | 82,143 | 107,093 |
| Susu Collectors (913 registered) | 249,177 | 257,609 | n.a. | n.a. |
| TOTAL (All RMFIs) | 1,838,243 | 2,258,792 | 360,834 | 457,366 |

This table shows that RCBs have the greatest outreach in terms of both borrowers and depositors and therefore play an important role in the success of microfinance in Ghana in the future.

Savings and Loan (S&L) Companies are another major component of the formal tier, but less relevant to rural Ghana. S&Ls are privately-owned companies that mobilize savings from households and small businesses, lend to micro, small, and medium enterprises, and provide consumer credit.^{lv} In contrast with RCBs, which are public companies owned by communities, private individual parties own S&L companies.^{lvi} However, S&Ls are mostly concentrated in urban areas and provide little outreach to the rural areas of Ghana. Currently there are only ten S&L companies operating in rural Ghana (refer to Table 4).

Semi-formal Sector

The semi-formal section includes credit unions and financial non-governmental organizations (FNGOs).

NGOs are non-member, not-for-profit organizations that provide charitable services to poor citizens. Their services include both financial (microloans) and nonfinancial (i.e. training and support) programs.^{lvii} The majority of microcredit NGOs belong to an umbrella organization, Ghana Micro Finance Network (GHAMFIN), which provides staff training and organizational capacity-building assistance and disseminates best practice guidelines and standards for governance, operations and performance efficiency.^{lviii} One particular example of a successful NGO in Ghana is Freedom From Hunger's (FFH) Credit with Education program, which uses individual savings with group credit to target women and provide accompanying education on health, nutrition, family planning, financial planning and budgeting and microenterprise development. Members of the program make mandatory savings contributions for at least three months before they qualify for a loan. FFH trains the loan officers for partner RMFIs (mainly RCBs) and the groups to handle the bookkeeping of the members' savings and repayments, so the program can be profitable.^{lix} This program has proven to be successful and has resulted in higher off-farm income from microenterprises, improved household food security, and improved nutritional status of children.^{lx} As evidenced in the case of FFH, NGOs play an important role in strengthening the quality and outcomes of RMFIs.

A second type of semi-formal supplier is Credit Unions (CU), which offer savings and loan facilities exclusively to its members.^{lxi} They average about 400-500 members and their average loan size is \$153.^{lxii} Individual members make predetermined periodical deposits into their accounts and may barrow up to two times their savings balance.^{lxiii} Most CUs require

borrowers to provide security and remain in good standing with their deposits.^{lxiv} The security can be in the form of a guarantee from another member in the CU who has an adequate savings balance. CUs operate independent from the government. Although, CUs have attempted to establish a formal financial reporting system for its members, they have been unsuccessful. The quality of the data is poor and for management purposes by the member societies, whose capacity is quite limited and whose managers, as well as board members, tend to have little understanding of the business financial intermediation.^{lxv} According to the Credit Union Association's own classification, at the end of 2001 over 60% of all Ghanaian credit unions were in an "unsatisfactory" situation and 15% were placed in the worst category.^{lxvi}

Informal Sector

The informal sector includes suppliers such as moneylenders, susu collectors, traders, and other informal mechanisms.

Moneylenders offer loan services that average three months and rarely exceed six months. The typical interest rate associated with loans from moneylenders is 25-30% for a three-month loan. Collateral against the loan is required and normally is in the form of physical assets such as buildings, farmland, and undeveloped land. Unlike commercial banks that incur large costs when attempting to liquidate the collateral into cash in the event that a loan goes into default and cannot be repaid, moneylenders can simply make use of the property until the debt is repaid. The importance of moneylenders has decreased as RCBs and CUs have emerged and offer moneylending types of services that are formally licensed.^{lxvii}

The "susu" system offers regular cash savings for the poor over periods of time, which usually range from one month to two years. Individuals known as susu collectors travel around the villages and collect daily amounts of cash set by the client and returns the accumulated

savings to client at the end of the month minus one day's amount as a commission. Susu collectors also offer a limited amount of credit to their most reliable customers. However, lack of capital, apart from savings they mobilize, constrains their ability to frequently loan large amounts of money.^{lxviii}

Traders, which operate between producers in rural areas and urban markets, are a major component of financing available to rural farmers in Ghana. The credit that traders provide is in the form of inputs (such as seeds) or cash advances against future outputs of the crops. Traders do not usually require collateral as a security against the loan, but instead opt for an agreement with the farmer to sell the trader the crop over an extended period of time at an interest rate of 50%. These traders are therefore viewed as exploitative due to the exorbitant interest rates that are imposed on the poor. However, for many farmers these traders are their only option to obtaining credit and therefore resort to this form of credit.^{lxix}

Besides traders and moneylenders, loans from relatives, friends, neighbors, and other acquaintances constitute the other main source of credit that is available to farmers and the rural poor.

VII. Inadequacy of Current Services

The three categories that make up RMFIs only meet 3% to 10% of the demand for micro credit.^{lxx} Therefore, there is a huge gap between the small supply of micro credit and large demand for it. Furthermore, a great deal of inequality of the poor's² ability to access financial services exists amongst various regions. This inequality is highlighted in Table 5.

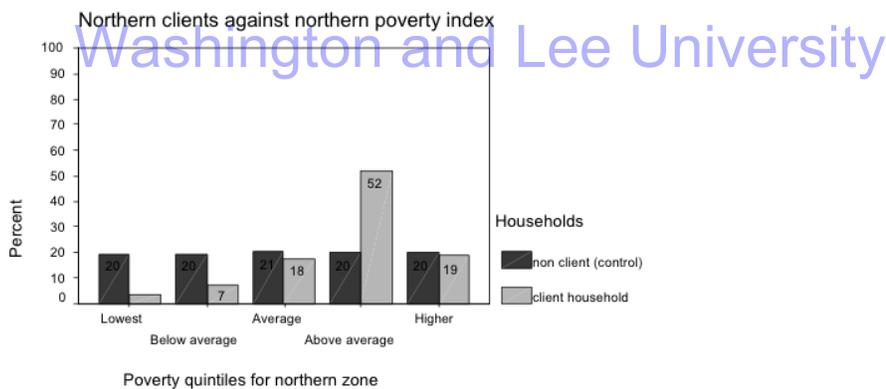
Table 5: Type of Financial Services Available in the Community (Percent)

| Region | Type of Financial Services | | | | | |
|---------------|----------------------------|--------|--------------|-------------------------------|-------|------|
| | Banking | "Susu" | Credit Union | Informal Private Money Lender | Other | None |
| Total | 29.0 | 29.0 | 9.0 | 3.0 | 0.0 | 30.0 |
| Western | 33.0 | 43.0 | 11.0 | 3.0 | 0.0 | 9.0 |
| Central | 38.0 | 39.0 | 11.0 | 1.0 | 0.0 | 12.0 |
| Greater Accra | 31.0 | 33.0 | 11.0 | 2.0 | 0.0 | 24.0 |
| Volta | 25.0 | 19.0 | 9.0 | 5.0 | 0.0 | 42.0 |
| Eastern | 23.0 | 34.0 | 7.0 | 5.0 | 0.0 | 31.0 |
| Ashanti | 32.0 | 36.0 | 8.0 | 5.0 | 0.0 | 19.0 |
| Brong Ahafo | 39.0 | 32.0 | 12.0 | 2.0 | 0.0 | 15.0 |
| Northern | 16.0 | 11.0 | 6.0 | 4.0 | 0.0 | 63.0 |
| Upper East | 13.0 | 16.0 | 4.0 | 3.0 | 0.0 | 65.0 |
| Upper West | 29.0 | 22.0 | 5.0 | 2.0 | 0.0 | 42.0 |

Again, the worst off regions are the three northern regions: Northern, Upper East, and Upper West with 65%, 63%, and 42% of the community without access to financial institutions.

Although RCBs have the greatest outreach as discussed above in the RCB section, they only reach a certain strata of the poor. Table 6 shows RMFIs poverty outreach in the Northern region.

Table 6: RMFIs Northern Region Poverty Outreach^{lxxi}



This table contrasts the poor that have access to RMFIs (client households) with the poor that do not have access to RMFIs (non client households; control group) in the Northern region. The table breaks down the outreach of services by poverty quintiles. If RMFIs were to serve all of the poor equally, every bar would be at the 20% line. However, looking at the 4th quintile of the poor, which are the people who are closer to the poverty line and not in extreme poverty, we see that 52% of RMFIs' clients are in this group, which makes them disproportionately served. In contrast, only 4% of RMFIs' work reaches clients in the first quintile. This group is in extreme

poverty and is the poorest of the poor in the Northern region. Therefore, we can conclude that RMFIs in the Northern Region are only reaching the “entrepreneurial poor” and therefore the poorest are left without access to financial institutions.

VIII. Obstacles of microfinance

When comparing urban and rural areas within the same country, a number of characteristic differences are observed. These differences can be classified into three main groups: (1) higher transaction costs, (2) higher systemic risks and more volatile cash flows, (3) lower risk bearing ability and higher vulnerability of rural households.^{lxxii}

Higher Transaction Costs

Financial institutions and their clients in rural areas face higher transaction costs, irrespective of the MFI model or type used. The reason is multifactorial. Firstly, there is lower population density and greater spatial dispersion of rural households, market and institutions. Therefore, costs of doing business increases because of the increased resources it takes to physically get to the clients. Secondly, rural infrastructure is inferior in quantity and quality, including communications, roads, and education. Thirdly, rural areas have lower levels of access to information, education, and business training.^{lxxiii}

Higher Systemic Risks and More Volatile Cash Flows

Decreased income diversification in the rural economy increases the volatility of rural households’ cash flows. In rural areas, there are fewer opportunities for employment than in urban areas because urban areas have a more diverse and larger job market. People who live in rural areas have fewer possible sources of income and are therefore more vulnerable to fluctuations in cash flows. Additionally, unpredictable weather dictates the agricultural sector, and because the entire rural economy is agriculturally based, volatility in this sector transcends

other sectors.^{lxxiv}

Lower Risk Bearing Ability and Higher Vulnerability of Rural Households

The incidence and depth of poverty leads to lower risk-bearing ability of households and enterprises. The lower level of human development, which includes, education, financial literacy, health and nutritional information, etc., coupled with the lower level (in terms of quality and quantity) of access to basic needs and services such as drinking water, health care, and social assistance, all result in higher vulnerability of households in rural areas.^{lxxv}

In addition to the constraints that make microfinancing in rural areas more difficult, institutional constraints exist as well. One of the main hindrances to microfinance in rural Ghana is that there are too few microfinance institutions in Ghana to provoke the spirit of competitiveness, which is a vital ingredient necessary to make commercial microfinance more responsive to the poor. A second problem is a lack of communication and coordination amongst the various RMFIs. There is no national body responsible for coordinating all activities within Ghana associated with microfinance. Therefore, best practices and standards setting for the industry are not shared. Additionally, the institutions lack adequate human capacity within the RMFIs. The staffing competency level being achieved within RMFIs is below that desired, and therefore the quality of the services that are provided are decreased. A fourth constraint is the limitation of funding. Funding comes from three main sources: institutions themselves, government and development partners. However the amount of funds currently available is inadequate to meet the demand. A final constraint is the lack of national framework for evaluating the institutions, which make it difficult to make comparative assessments of programs and projects for their impact on the performance of institutions and clients.

Constraints Facing Farmers in Particular

Agricultural limitations make financing poor farmers even more difficult. Productive assets for poor farmers in the north have a relatively low rate of return but can still help them out of poverty. The lengthy production process associated with farming makes it difficult for farmers to have an immediate cash flow once they receive a loan. Therefore, it is difficult for farmers to immediately begin repaying loans on a monthly basis. Additionally, unreliable weather conditions make lending to agriculture more risky than other business sectors. Also, as discussed above, transaction costs are higher in rural areas because the cost of doing business is greater. Therefore, it becomes difficult to keep interest rates low because financial institutions need to cover their costs and risks. This adds 3-5% per month to the interest rates and farmers cannot afford to borrow at high rates to finance assets and RMFIs cannot lend at low rates.^{lxxvi}

IX. Recommendations for future: Combining top-down and bottom-up approaches

In order for microfinancing to be a successful poverty alleviation tool in rural Ghana, a combination of top-down and bottom-up approaches, involving the financial institutions and grassroots efforts respectively, is warranted.

From the top, which includes financial systems and the Ghanaian government, there is a need for incentives, which will increase RMFIs to *reach down* to provide financial services directly to low-income communities. In order to achieve this, the capacity of the existing RMFIs needs to be strengthened. The first objective is increasing the ~~human~~ capabilities of the people that run the RMFIs. This can happen through a strong and sustainable training program for the staff that focuses on business planning, financial statement analysis, calculating riskiness of borrowers and adjusting the interest rate accordingly. Additionally, seminars should be implemented so that RMFIs can gather together to share best practices. An increase in

collaboration and coordination amongst the various RMFIs and across the different tiers will strengthen the capacity of the institutions.

The second objective is to increase the infrastructure in the northern region. The Ghanaian government should invest in establishing basic infrastructure (roads, telephones, electricity). This basic infrastructure will lead to decreased transaction costs and therefore an increase in the amount of financial services available to the northern poor.

The third objective involves financing rural farmers through matching grants. Finding an effective way to finance poor rural farmers has to be innovative because their situation is multifaceted. Poor framers cannot afford to borrow heavily at high rates to finance assets and RMFIs cannot afford to lend at low rates due to the increased costs of doing business in rural areas. Therefore, subsidies are required in such a way that they leverage savings. However, subsidies on interest rates are self-defeating because they cannot cover the costs of servicing loans because that leads to RMFIs being unsustainable. RMFIs are able to stay in business based on the higher interest rates that they charge. Additionally, subsidies on interest payments typically undermine the pressure of the obligations to repay the loan because it signals to borrowers that the loan is a social benefit, not a business deal. Therefore the solution to this situation comes from the top, the Ghanaian government, who should provide matching grants for the costs of assets.

From the bottom, assistance from grassroots community-based organizations is imperative. First, these organizations can help improve the business and financial management skills of the borrowers. In order to ensure that microfinance functions as a poverty reduction tool, services must go beyond simply providing credit. The specific circumstances that the rural poor in northern Ghana face needs to match the approach of microfinance services. Therefore,

these types of services, which increase human capability, are imperative to ensure positive results from access to credit and high loan repayment percentages. The second vital role that community-based organizations play is *linking up* RMFIs. Commercial banks have a much larger supply of funds than that of RMFIs. By NGOs establishing a connection between the existing RMFIs and commercial banks, the potential outreach of credit greatly increases and the supply of funding is more stable and reliable. A third function of NGOs is establishing a formal system for the needed collaboration and coordination as discussed above.

X. Limitations of Microfinancing

Microfinancing is not a magic bullet for eliminating all poverty. Instead microfinancing needs to be viewed as a tool, among many. When channeled properly it can make positive impacts on the economy and improve the livelihood of the poor. However, this tool is most successful when basic human needs are met and basic institutions and infrastructure are in place in the region that microfinance is targeting. For example, if a particular community lacks roads, electricity, basic communication such as phones, adequate education institutions, and HIV/AIDS plagues a large majority of the people, microfinancing will not be very effective. It will be difficult to physically reach the clients and the human capabilities of the clients are very limited due to health problems and lack of education. These conditions make it difficult for clients to repay loans and therefore diminish the benefits of microfinancing. Instead, increased access to credit needs to be coupled with better infrastructure (roads, safe water, electricity, telephone services) as well as institutions (social services, educational services, and health services). As Jeffrey Sachs said, “By itself, microfinancing is unlikely to be the single missing element that unlocks economic growth, but if one is simultaneously approaching the challenges of a region

through basic infrastructure, such as roads and power, and public health and education, and strengthening agriculture, then the additional benefits of microfinancing can be significant.^{»lxxvii}

Another common limitation to achieving the greatest possible benefit of microfinancing is unstable governments. Fortunately, Ghana's government has identified microfinancing as a key strategy to poverty reduction and is very supportive of this tool. Additionally, Ghana's government is generally stable and not corrupt. In fact, Ghana's international ranking on corruption indicators is the best among low-income African countries.^{lxxviii} Additionally, Ghana has a stable and well functioning democratic system in place. Ghana's political rights, civil liberties and freedom of press rankings are not only amongst the best in Africa but are comparable to those recorded by countries at much higher levels of income.^{lxxix} However, this type of stable government is not typical of most low-income countries. Instead, autocratic and unstable governments rule many of these countries. This type of atmosphere hinders the possible benefits that microfinancing can provide to a region.

Microfinancing is also limited by its inherent structure that fails to *directly* reach the poorest of the poor. I say, "directly," because the poorest of the poor will most likely not be issued a business loan. There is a small chance that the poorest of the poor could benefit through employment at a business that receives a loan or other benefits that could trickle down to them. However, the problem with this is not only the amount of time it takes for these effects to reach the poorest of the poor (that is if it ever does), but also the fundamental problem that the poor lack access to traditional forms of financing still goes unresolved.

XI. Conclusion

It is vital that the rural poor have access to credit in order to improve the conditions of their lives. The poor in rural Ghana, such as Apasare and his family can benefit greatly by

gaining access to such services because it improves their ability to manage risks, such as inclement weather during the harvesting season, and still be financially stable to meet basic needs. The benefits of microfinance for individuals also transcends to the local community, as well as the country as a whole, by increasing the productivity and growth. However, the current financial services in rural Ghana are inadequate and a large majority of the rural poor are left without access to credit.

A long held myth that people in developing countries who make less than a dollar per day are not creditworthy and unable to payback loans, has been proven false. It has been found that poor households in developing countries place special value on reliable and continued access to various types of financial services that are reasonably priced and cater to their specific needs.^{lxxx} Therefore, this myth can no longer serve as a credible argument for excluding the poor from formal financial services. In alignment with the second and fourth key factors driving microfinance, the poor do have the capacity to use loans effectively for income generation and RMFIs are able to become sustainable because the poor can repay the loans.

In order for the poor to have access to financial services, it requires that the institutions that supply the credit are sustainable over the long term. In order to obtain this security, a top-down and bottom-up approach needs to take place. RMFIs and the government need to increase the services and outreach from the top and grassroots efforts need to increase the capacity and communication amongst the three tiers of financial institutions from the bottom.

With these reforms, we still need to be mindful that microfinancing is not a panacea for all poverty alleviation. As discussed above, the poorest of the poor are not going to be

serviced by RMFIs because it would not be sustainable in the long run. Consequently, other approaches and services such as improved educational services and increased investments in building up the northern infrastructure needs to take place.

Microfinance is a promising tool that if channeled properly in conjunction with other complementary measures offers hope for alleviating poverty for Apasare and his fellow Ghanaians.

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